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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY,
Petitioner,

vs.

NIGEL D. CAMPBELL and the
UNITED STATES OF AMERICA,
Respondents.

PETITION FOR REHEARING

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PETITION FOR REHEARING

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner prays this Court for a rehearing, pursuant to Rule 33, Subdivision 2, of this Court. The argument will be confined to what are believed to be substantial grounds available to petitioner, although not previously presented.*

It is respectfully urged that the petition should be granted for the following reasons:

1. the questions involved in the determination of this case are a matter of public importance by reason of the volume of similar cases pending in the Bureau of Internal Revenue;

*The facts are summarized in our petition for a writ of *certiorari*, pp. 3-8.

2. the failure of Congress for many years to amend in any relevant respect the provisions of Section 101(6) of the Internal Revenue Code indicates, in the face of numerous decisions of lower federal courts interpreting that section favorably to exemption of corporations such as petitioner, an acquiescence in such interpretation; such acquiescence is compatible with petitioner's view as to the correct interpretation of the statute;

3. the enactment of the Revenue Act of 1950 indicates that the questions involved in this case are of importance; and

4. the case at bar is not, to any substantial extent, factually distinguishable from many lower federal court decisions, although the decision of the Seventh Circuit here is in conflict with them; such minor factual differences as may exist should not deprive petitioner of a review, where the same basic legal principles are involved.

1.

There are, we are informed, many cases pending in the Bureau of Internal Revenue, involving large sums, in which the principles at stake are the same as in the instant case. The conflict between the instant case and other cases, hereinafter referred to, previously decided by United States Courts of Appeals is such as to create here an adequate vehicle for the settlement by this Court of the questions involved. A determination by this Court of those principles would presumably dispose of the large volume of such tax cases still pending before the Bureau. Under these circumstances there remains, in spite of the radical change of the law by the Revenue Act of 1950 in regard to the issues

here involved, a substantial public interest in an authoritative interpretation of Section 101(6) of the Internal Revenue Code as it existed prior to the enactment of the Revenue Act of 1950.

2.

The substance of Section 101(6), in all relevant respects in the form here sued upon, first appeared in 1913 (38 Stat. 172); since that time it has been reenacted, sometimes with amendments,* on ten occasions, not including its incorporation in the Internal Revenue Code in 1939. 39 Stat. 766; 40 Stat. 1076; 42 Stat. 253; 43 Stat. 282; 44 Stat. 40; 45 Stat. 813; 47 Stat. 193; 48 Stat. 700; 49 Stat. 1674; 52 Stat. 481.

On May 28, 1938, subsequent to *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776, the Section was reenacted by Congress without change. 52 Stat. 447, 481. Until the decision of the Court of Appeals for the Seventh Circuit in the instant case, the principle of the *Roche's Beach* case, which we submit is indistinguishable from the instant case (see p. 9, *infra*), was consistently followed.**

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*Never, however, substantially affecting the provisions here relied upon.

***Commissioner of Internal Revenue* v. *Orton*, 6 Cir., 173 F. 2d 483; *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.*, 2 Cir., 148 F. 2d 948; *Commissioner of Internal Revenue* v. *Battle Creek*, 5 Cir., 126 F. 2d 405; *Bohemian Gymnastic Ass'n Sokol of City of N. Y.* v. *Higgins*, 2 Cir., 147 F. 2d 774; *Home Oil Mill* v. *Willingham*, N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion Jan. 9, 1946, C. C. H. Fed. Tax, 1950 Index 20,627; *Home Oil Mill* v. *Willingham*, N. D. Ala., 86 F. Supp. 568, *aff'd*, 5 Cir., 181 F. 2d 9, *cert. den.*, October 16, 1950. *Bear Gulch Water Co.* v. *Commissioner of Int. Rev.*, 9 Cir., 116 F. 2d 975, *cert. den.*, 314 U. S. 652, is not believed to have been a deviation from the *Roche's Beach* doctrine (see Reply Brief of Petitioner, pp. 4-5).

Meanwhile the Bureau of Internal Revenue, until 1942, accepted the *Roche's Beach* rule. G. C. M. 20853, Cum. Bull. 1938-2, p. 166; G. C. M. 21610, Cum. Bull. 1939-2, p. 103; G. C. M. 22116, Cum. Bull. 1940-2, p. 100; *contra* G. C. M. 23063, Cum. Bull. 1942-1, p. 103.

On March 3, 1942, the Committee on Ways and Means was told by Mr. Randolph Paul, then Tax Advisor to the Secretary of the Treasury, that many corporations engaged in general business activities remained exempt from tax and that such corporations should be taxed on the income derived from businesses not necessarily incident to their exempt activities. As Mr. Paul stated (Vol. 1, Hearings Before Committee on Ways and Means, H. R., 77th Cong., 2d Sess., on Revenue Revision of 1942, p. 89):

> "Our revenue laws have been generous in exempting certain corporations from the income tax. Thus charitable or educational corporations are not subject to the corporate income tax. Many exempt corporations, however, have so far departed from the purpose of the exemption as to engage in trades and business completely unrelated to their exempt activities, and yet the income of such business activities remains exempt from tax. If a college operates a hotel, the earnings of the hotel are exempt; if an orphans' home operates a waterworks and an electric power and gas company, the earnings of these utilities are exempt; if a charitable organization operates a bathing beach, the earnings of the beach are exempt. In this way sources of considerable tax revenue are withdrawn from the scope of the tax. At the same time privately owned businesses are forced to compete with other businesses not subject to an income tax.
>
> "It is believed that the exemptions accorded to such organizations should not be so distorted. It is

> therefore suggested that such corporations be taxed on the income derived from a trade or business not necessarily incident to their exempt activities."*

It is noteworthy that Mr. Paul was obviously referring to *Unity School of Christianity,* 4 B. T. A. 61 (a corporation organized under the Missouri Business Law); *Sand Springs Home,* 6 B. T. A. 198 (a corporation empowered by its charter to engage in the normal activities of a business corporation); and *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776 (involving a corporate taxpayer organized under the New York Stock Corporation Law), respectively. Specifically, in the *Roche's Beach* case, the corporation (taxpayer) had no function except to operate its bathing beach business, and the charity received its net earnings only by virtue of the trustees of the charity owning all of the stock of the corporation,—just as is the case with petitioner herein. Yet the corporation itself was held exempt from federal taxation.

In spite of Mr. Paul's recommendation, Congress took no action at that time with respect to Section 101(6) although it did amend Section 101(16). Revenue Act of 1942, § 137. Thereafter, although the Internal Revenue Code was repeatedly amended in other respects, Section 101(6) remained unchanged until September 23, 1950, when the Revenue Act of 1950 was enacted.

Under these circumstances, we respectfully submit that Congress, prior to 1950, acquiesced in the construction placed upon Section 101(6) in the *Roche's Beach* case and other decisions.

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*The similarity between Mr. Paul's recommendation and the Revenue Act of 1950, as enacted, is apparent.

This Court has consistently held that failure of Congress to change a statute as judicially interpreted, particularly where as here the interpretation is called to its attention and action has been taken upon the statute in other respects, is presumptive evidence that the interpretation is in accord with the intent of Congress. *Francis* v. *Southern Pacific Co.*, 333 U. S. 445; *United States* v. *South Buffalo R. Co.*, 333 U. S. 771; *Walling* v. *Halliburton Co.*, 331 U. S. 17; *Brooks* v. *Dewar*, 313 U. S. 354; *Apex Hosiery Co.* v. *Leader*, 310 U. S. 469; *Electric Battery Co.* v. *Shimadzu*, 307 U. S. 5; *Missouri* v. *Ross*, 299 U. S. 72; *U. S.* v. *Elgin, J. & E. Ry.*, 298 U. S. 492; *United States* v. *Ryan*, 284 U. S. 167; *U. States* v. *R. T. Hooe*, 1 Cranch 318.

The principle involved was enunciated at an early term of this Court, presided over by Chief Justice Marshall, *U. States* v. *R. T. Hooe*, 1 Cranch 318.

It has been followed ever since. (See cases cited above.) Thus, in *Missouri* v. *Ross*, 299 U. S. 72, this Court said (p. 75):

> "These decisions are plainly correct; but if they were doubtful, we should at this late day hesitate to disturb them. *United States* v. *Ryan*, 284 U. S. 167, 174. Moreover, Congress in the face of these decisions has permitted the clause as it now appears in paragraph (6) to stand for many years without change in its phraseology, although amending that portion of the Bankruptcy Act in other particulars. This is persuasive evidence of the adoption by that body of the judicial construction."

The unsuccessful effort of the Treasury Department in 1942 to secure an amendment to Section 101(6) adds weight to the view that the *Roche's Beach* case correctly interpreted the Congressional intent. *United States* v.

South Buffalo R. Co., 333 U. S. 771; *Trade Comm'n* v. *Bunte Bros.*, 312 U. S. 349.

Moreover, the doctrine is not limited to interpretations by this Court. In *Missouri* v. *Ross*, 299 U. S. 72, *supra*, and *Manhattan Prop.* v. *Irving Tr. Co.*, 291 U. S. 320, it was specifically held that the inaction of Congress in the face of lower federal court decisions was persuasive evidence of the adoption by that body of the judicial construction.

The acquiescence of Congress appears all the more probable upon an inspection of Section 101(6). On its face, it seems clear that that Section exempts a stock corporation engaged in business activities where, as here, its net earnings are irrevocably dedicated to exempt purposes. The Section exempts "corporations" no part of the "net earnings" of which inures to the benefit of any "private shareholder" or individual. This patently envisages a stock corporation actively operating for profit, incurring expenses and distributing its "earnings", less expenses, to stockholders who are of the exempted class. Obviously, the corporation may have stockholders for the statute merely requires that no part of its net earnings may inure to the benefit of a *"private* shareholder". Equally obviously, the corporation may be one which *operates* for *profit;* otherwise, it would not have "earnings", as distinguished from rent, interest, or other types of income*, from which would be deducted expenses of operation resulting in "net earnings", no part of which, according to the statute, may inure to the benefit of a

*As Mr. Justice Minton, then Circuit Judge, has said: "The word 'earnings' denotes an 'economic good to which a person becomes entitled for rendering economic *service*'" (italics supplied). *National Labor Relations Bd.* v. *Marshall Field & Co.*, 7 Cir., 129 F. 2d 169, 171. See also *Arey* v. *George Associates, Inc.*, 299 Mass. 130, 135, 12 N. E. 2d 84, 87; *Webster's New International Dictionary* (2d Ed.), "Earnings".

private shareholder. That the corporation may operate for *profit* is further indicated by the circumstance that exempt organizations in other subsections of Section 101 are forbidden to operate for profit, whereas no such restriction is expressed or implied in Subsection (6).* Had Congress not intended that 101(6) corporations be operated for profit, they could have been included in Section 101(7) by the mere addition of the word "corporations" to the list of organizations there set forth.

Section 303 of the Revenue Act of 1950, which provides that no inferences shall be "drawn from the fact that the amendment made by such section [Section 301(b)] is not expressly made applicable with respect to taxable years beginning before January 1, 1951", does not in any way affect inferences which may properly be drawn from the inaction of previous Congresses or from omissions from previous legislation. So it does not preclude or weaken the arguments presented in this petition as to the Congressional intent as it existed *before* the passage of the Revenue Act of 1950.

Under all of the circumstances, it seems to us, Section 101(6) on its face encompasses a corporation engaged in business and operating for profit and a Congressional intent to that effect is demonstrated.

3.

In any event, Title III of the Revenue Act of 1950 represents a radical departure, effective as to taxable years beginning after December 31, 1950, from the exemption

*Thus, Subsection (4) applies to cooperative banks "operated * * * without profit". Subsection (7) applies to business leagues and the like "not organized for profit". Subsection (8) applies to civic leagues "not organized for profit". Subsection (9) applies to clubs, organized and operated for "nonprofitable purposes".

provisions of all prior revenue acts enacted since the effective date of the Sixteenth Amendment to the Constitution. It is perfectly clear from a reading of the Revenue Act of 1950 that Congress intended to inaugurate an entirely new approach to the problem of exemptions from federal income taxation. The completeness and thoroughness of the new legislation emphasizes, beyond any necessity for argument, that Congress did not intend a mere clarification of existing law, but clearly intended to *change* the law. This is, in itself, of considerable value in interpreting the Section under which this case was brought and is also cognate to the consideration of whether or not Congress has not heretofore acquiesced in the interpretations given Section 101(6) by federal courts, which we have treated in 2 above.

Moreover, it clearly appears that the question of exemption from federal taxation was of such importance to Congress as to lead that body to legislate extensively concerning it in the Revenue Act of 1950. We respectfully submit that it is of equal importance to the public that the interpretation of Section 101(6) be authoritatively determined by this Court as to the large number of outstanding situations.

4.

In the instant case the Court of Appeals (R. 1063, 1076-77) sought to distinguish the instant case from other cases, cited above, of courts of appeals in which exemption was granted.* This was done by holding, contrary to the find-

*In our petition for a writ of *certiorari*, we urged that the Court of Appeals erred in drawing a factual distinction between the case at bar and the other decisions of courts of appeals in conflict herewith. We did not, however, point up that argument by quoting the findings of the District Court and seeking to sustain them affirmatively, as against pointing out the error of the Court of Appeals. That omission is sought to be supplied in this point.

ing of the District Court, that petitioner granted, "royalty free," the right to use its inventions to certain of its former security holders and, therefore, continued to be operated for their benefit.

We urge that there is no evidence to support this holding by the Court of Appeals. The only testimony in the case on the subject was unambiguously to the effect that the transactions referred to were ordinary business transactions between petitioner, on the one hand, and its security holders and others who were not its security holders, on the other hand; that the transactions were at arm's length, supported by ample consideration to petitioner, and highly beneficial to it; and that, far from detracting from petitioner's value or constituting a siphoning off of petitioner's profits, such agreements actually added substantially to the value of the *res* of The Petroleum Research Fund, a concededly exempt organization.

We submit that the following findings of the District Court, which heard the witnesses, are the only findings supported by the evidence (Findings 44, 45, R. 931):

> "In 1931 South Dakota [petitioner's predecessor], and subsequently plaintiff [petitioner], entered into a number of agreements with various oil companies. Some of the parties to some of such agreements were on various occasions prior to November 29, 1944, stockholders or noteholders of plaintiff. Such agreements were entered into, however, with stockholders, noteholders and others indiscriminately. These agreements were the means by which South Dakota and plaintiff built up a patent structure, acquired additional know-how and in general broadened the base of their services. Some of said agreements are set forth in Exhibits 40-50, 76-80, NN, OO and PP. As a result of the agreements, South

Dakota and plaintiff were able to terminate, and avoid the expense of, vexatious litigation, reassure their customers against the harassment of suits and threatened suits and build up a reservoir of processes by which they have been enabled better to serve their customers, which in general have been the smaller so-called independent oil refining companies without research and experimental resources of their own. None of said agreements was intended to have, or did have, the effect of causing plaintiff to be operated for the benefit of any of the other parties thereto or of their successors and none of said agreements had the effect of distributing any of plaintiff's net earnings to, or otherwise causing its net earnings to inure to the benefit of, the other parties to said agreements.

"The said agreements conferred valuable rights on plaintiff, were designed to and did in effect improve the position of South Dakota and plaintiff with respect to serving the public. Part of the value of plaintiff to The Petroleum Research Fund arises from these agreements."

Whatever superficial factual differences may have existed between the instant case and the decisions of other courts of appeals in conflict therewith, they in no wise detract from the availabilty of the instant case as an appropriate vehicle for the interpretation of Section 101(6) with respect to this and numerous other cases which, we are informed, are now pending in the Bureau of Internal Revenue. Certainly such superficial divergence, not affecting the principles involved, should not deprive your petitioner, which is first in time in making its application for a writ of *certiorari*, of the opportunity to have its own case reviewed by this Court.

CONCLUSION

For all of the foregoing reasons, petitioner respectfully prays that this Court grant a rehearing and issue its writ of *certiorari* for the purpose of determining the questions submitted.

Respectfully submitted,

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Petitioner,

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CERTIFICATE OF COUNSEL

The undersigned hereby certifies that the foregoing petition for rehearing is presented in good faith and not for delay and that the petition is restricted to the grounds above specified.

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